

The Implications and Effects of Privatizing Social Security

An Honors Thesis (HONRS 499)

By

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A handwritten signature in black ink, reading "Jensen J. Zhao". The signature is written in a cursive style with a horizontal line underneath the name.

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Abstract

In recent years, the idea of privatizing Social Security in the United States has been a popular reform solution. Privatizing Social Security already poses many questions as to whether or not this solution is the best one for our social insurance program. This paper addresses the issues of Social Security privatization and looks at both sides to analyze the varying viewpoints.

The first chapter in this paper deals with Social Security's history in the United States as well as the answer to the question of how it is financed. When Social Security was put into action on August 14, 1935, it changed the lives of millions of Americans. With this new program, financial instability would become less of a threat for retirees and disabled workers. With the many amendments that have been made since 1935, Social Security has shown it can change with the needs of people relying on this program.

The second chapter focuses on the current problems the Social Security program is experiencing as well as an overview of privatization. Many people believe Social Security is going broke. Certain indicators reveal the amount of current workers per retiree drawing Social Security benefits is greatly reducing. It is believed the Social Security trust fund will go broke in the year 2038. This is because outlays will have exceeded the revenue to the point of total exhaustion of funds. This is where the issue of privatization enters the picture. Many people believe privatization is the answer. Privatization is not a new concept to the world because many Latin American countries are currently operating their social insurance programs in such a way. Looking at privatization of other social insurance programs around the world is a big indicator of

what a privatized system can do to the country's social insurance program and even the economy.

The third chapter looks at the debate of whether or not a privatized Social Security program is feasible. There are many plans for privatization, most of which improve upon earlier suggestions. Some of the most recent privatization plans mirror those in Latin American countries where problems are already being seen. Those who are against privatization see this kind of reform as too radical. They argue that through such a system, the main thing missing is "security."

The last chapter focuses on a conclusion and recommendation for Social Security's problems. It is obvious repercussions will take place if the United States imposes a privatized system because of the analysis of privatization in Latin America. My recommendation is to avoid privatization at all costs. There are other things that need to be done in order to keep Social Security alive. Equality in taxing for those making more than \$72,600 a year is a key solution to some of the problems Social Security is having. My second recommendation is to increase the interest rates of government bonds. This will help create a surplus should it be needed in the future. My third recommendation is to prohibit governmental "borrowing" from the fund. This will help ease the problems that Social Security may have in the future.

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Introduction

In recent years, the idea of Social Security privatization has become increasingly popular due to the need of reform. This thesis will explain the advantages and disadvantages of such a system and ultimately state my stance on whether the Social Security program should or should not be privatized. This paper will collect various types of data and excerpts from economists, professors, sociologists, labor unions, and current workers in the United States as well as my input on reform possibilities.

It is important for individuals to look at this subject in a serious manner. The regulations that may be put on Social Security will greatly impact every worker who plans to retire at some point in his or her life. This issue is an important one that can affect the whole United States work force and even those who currently depend on Social Security to pull them out of a poverty-stricken living arrangement. This paper will provide a better understanding of the issues of privatizing Social Security and its possible short-term and long-term effects.

Chapter 1 – The Birth of a Social Insurance Program

INCEPTION

“This is a law that will take care of human needs and at the same time provide for the United States an economic structure of vastly greater soundness.” As stated on August 14, 1935, President Franklin Delano Roosevelt provided the basis for what we know today as the Social Security program (Social Security Administration, Brief History 9). This new idea, which was a subcategory in Roosevelt’s New Deal, was a welcome change for Americans who looked positively on this plan to provide pensions for most workers aged 65 or older. According to the Social Security Administration’s web site history page, at the same time, a joint federal-state system of unemployment insurance was established. As groundbreaking as this plan was in the United States, the underlying principle of Social Security was not a new one to the world.

Originating during the Industrial Revolution, social insurance was established to protect workers by decreasing the amount of economic insecurity that may be present. The basic belief in this program was society as a whole should be responsible for the protection of its own members. The government, in turn, would protect the money invested in this program for its inevitable use. The first country to adopt a social insurance program was Germany around 1883. France followed with a program of its own in 1905. A slew of countries jumped at the idea of a social insurance program, and by the mid-1920s, Japan, Great Britain, New Zealand, and some Latin American

countries had established their own programs. The program in Latin America will be discussed later in this report.

Following the trend of adopting a social insurance program and a crippling depression, it seemed only proper for the United States to join the global interest in such a program. President Roosevelt announced this plan on June 8, 1934, which stated his intention to construct a social insurance program. A committee was then established to study the entire problem of economic insecurity and to make recommendations that would ultimately serve as the basis for the Social Security program. When the research was completed, President Roosevelt immediately reported to both Houses of Congress. After a lengthy compromise process by each side, the Social Security Act was passed on August 14, 1935. Implementing this new law meant a substantial amount of work was ahead (Social Security Administration, Brief History 9).

Created at the request of President Roosevelt, the Social Security Board had the daunting task of providing employers, employees, and the public information on how this system will work for them as individuals. Field offices were also to be established and staff had to be selected and trained. The goal was to have every employer and employee registered by January 1, 1937. To accomplish this, the U.S. Postal Service was contracted to distribute and collect applications. Upon receipt of these applications, a number would be typed on a card for the applicant. All the information would then be forwarded to the Social Security Board's headquarters in Baltimore, Maryland. Once all information was collected, lump sum benefits could be paid to those who retired after the onset date of the law. The first lump sum check was for 17 cents to a retired Cleveland

motorman, Ernest Ackerman. Beginning in 1942, monthly benefits would be paid to retirees (Social Security Administration, Brief History 9).

EVOLUTION AND AMENDMENTS

As intricate as the Social Security Act was, changes and amendments were unavoidable for the law to remain a success. The first amendment to the original act came four years after the law came into effect. The 1939 Amendments added two categories to beneficiaries. These were payments to spouses and dependents of a retired worker as well as survivor benefits paid to the family in case of a death of a working family member. This was a landmark amendment in that the Social Security Act now blanketed not only retirees but also their families, making the act a family-based security program. Added on to the previous additions were an increase in benefits paid and an earlier startup date for monthly benefits, now being paid in 1940 instead of 1942. In January of 1940, the first monthly benefit check was paid to Ida May Fuller, who received \$22.54 (Social Security Administration, Brief History 9).

Over ten years passed before a new amendment was made to the Social Security Act. The 1950 Amendments were also a landmark in Social Security's history. Over the course of those 11 years, it was widely known that Social Security was still in its building stages, and therein necessitated a need for changes. The problem began when it was noticed welfare payments to retired workers were actually higher than what Social Security was paying. The amendments raised the benefits for the first time and made the program's coverage more respectable. Another important provision was the

implementation of a cost-of-living adjustment (COLA). From 1940 to 1950, Social Security did not adjust itself for inflation. Upon realizing this, Congress legislated the first cost-of-living adjustment, which increased checks that year 77 percent. It was then that Congress would be allowed to increase benefits as it saw fit. It wasn't until 1972 that Congress lifted that moratorium to allow for a yearly cost-of-living adjustment to offset inflation yearly rather than at the will of Congress.

The 1954 Amendments saw another major step for Social Security – the addition of a disability program (Grolier's Interactive Encyclopedia, 1997). This provided additional coverage to people who may have economic insecurity. With this amendment, a worker's Social Security records were put on hold if he or she became disabled and unable to work. This was important because their disabilities could not affect their chances for future retirement benefits. In 1956, an amendment was placed to provide disability benefits to workers aged 50-65 and disabled adult children. In 1958, this amendment was broadened to include disabled workers who were under the age of 50 as well as their dependents. Eventually, a worker of any age who was disabled was entitled to benefits.

In 1956, women were given the option to receive benefits earlier than what was originally mandated as law. This allowed them to get benefits at 62 rather than 65. Men were given this option with the passing of the 1961 Amendments. During the 1960s, another major amendment was passed. This allowed for the introduction of Medicare, a health coverage plan for people 65 or older or those receiving disability benefits. Social Security maintained full responsibility for Medicare until a 1977 revision placed it in the hands of the newly created Health Care Financing Administration (HCFA).

In the original act of 1935, programs were created for the needy aged and blind individuals. State and local government administered these programs with little help from federal funding. By 1969, the complexity of these state-run programs were causing many inconsistencies, namely a wide variety of the amounts of benefits being paid to these people. President Richard Nixon saw a need for reform and proposed the Social Security Administration assume full responsibility for these programs. These small programs were joined together in one program called Supplemental Security Income (SSI) in 1971.

Many changes were made to the disability program in the eighties. Work incentive provisions were introduced in 1980 for both recipients of Social Security and Supplemental Security Income disability benefits. Also introduced that year was the vast workload of disability reviews. With this addition of responsibility, Social Security had to conduct reviews of all cases of people drawing disability benefits. It was also at this time that the Social Security program was facing a very serious financial crisis. President Ronald Reagan appointed a group called the Greenspan Commission to conduct an in-depth review of the financial issues of Social Security and ultimately make recommendations for major changes that need to take place. There were two major changes that took place after the final report was sent to President Reagan. Social Security benefits would now be taxed and the raising of the retirement age beginning in the year 2000.

Not many changes were made to the Social Security program until 1996. The disability program would no longer pay benefits to people who were disabled due to drug abuse or alcoholism. President Bill Clinton also signed a legislation terminating

Supplemental Security Income benefits for nearly all non-citizens and also tightening the eligibility rules for children claiming Supplemental Security Income benefits. In 1999, President Clinton signed the “Ticket to Work and Work Incentives Improvement Act of 1999.” This act presented disabled beneficiaries with the opportunity to purchase services from vocational rehabilitation, employment services, other support services from an employment network of their choice. The law also provided these beneficiaries with incentive payments to providers when a beneficiary successfully returns to work. This revision was a major step for Social Security by leaning more towards rehabilitating disabled Americans and assisting them back to a successful work life. Finally, in 2000, President Clinton signed a law eliminating the reduction of benefits to senior citizens who were working and collecting benefits. This was the last in a string of major changes during the nineties and into the year 2000. A list of important dates in Social Security history is provided in Appendix A.

WHERE THE MONEY GOES

There are always many questions as to how the system actually works. According to the Social Security Administration’s web site, when someone works, taxes are taken out of every paycheck. Eventually, when that person retires or becomes disabled, he or she and their family may collect monthly benefits from Social Security. In the unlikely event a worker should die, that person’s family would receive survivor benefits. This process sounds strikingly simple, but the inner workings are more intricate than what one may assume (Social Security Administration, “How It’s Financed”).

Social Security taxes from a paycheck are split into two parts. These are Social Security benefits and Medicare coverage. Supplemental Security Income benefits are financed differently from Social Security benefits. They are financed through general tax revenues, not through Social Security taxes. The money that goes into Social Security and Medicare is also not completely taken from the worker's paycheck. A total of 15.3 percent of a worker's wages goes to Social Security. The worker pays 7.65 percent of that total from his or her paycheck, and the employer matches this exactly with his or her own tax payments. If a worker is self-employed, he or she has to pay the full 15.3 percent to Social Security (Social Security Administration, "How It's Financed").

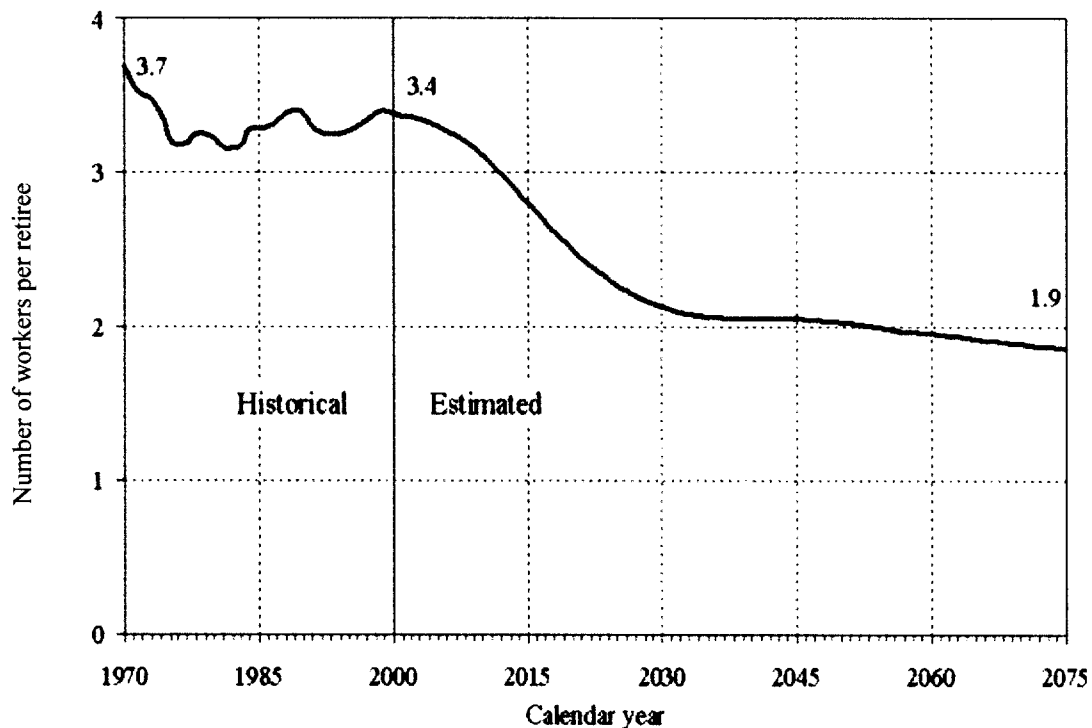
Now that the money has been taken out of the worker's paycheck, it has to go somewhere. Social Security and Medicare each have trust funds into which benefits will go. With Social Security, a portion of the percentage goes to the federal Old-Age and Survivors Insurance (OASI) trust fund. This is used to pay for retirement and survivor benefits. Another portion from Social Security goes into the federal Disability Insurance (DI) trust fund. This is used to pay benefits for people who are disabled and their families. Medicare is also split into trust funds. The federal Hospital Insurance (HI) trust fund is used to pay for the services covered under the hospital insurance (Medicare Part A) provisions of Medicare. The federal Supplementary Medical Insurance (SMI) trust fund is used to pay for the services covered under the medical insurance (Medicare Part B) Medicare provisions. Of the 7.65 percent a worker pays to Social Security, 5.35 percent goes to the Old-Age and Survivors Insurance trust fund. The Disability Insurance trust fund collects .85 percent of the paycheck. The remaining 1.45 percent goes to the Hospital Insurance trust fund (Social Security Administration, "How It's Financed").

These trust funds are continuously busy. Every day, Social Security taxes are put into these funds. Part of the money is paid to beneficiaries. Any money not needed on the day it is invested is immediately turned over to invest in government bonds. In the past, Social Security was financed on the popular “pay-as-you-go” basis. With this process, taxes go into the funds, and it will immediately and equally go to beneficiaries without any amount of saving. This became a problem when it was projected the entire trust fund for Social Security will be exhausted in the future. It was because of this idea that since 1983, when Reagan’s Greenspan Commission conducted its analysis of the state of Social Security, the system has been trying to build up a reserve fund that will help pay for the benefits of the growing number of people anticipating to retire. The investments are made in government bonds, the safest of all kinds of bonds. In 1998, the Social Security trust funds earned \$49.3 billion in interest. This is to be a drop in a large pool of collections for the inevitable retirement of the Baby Boomer generation, which will be discussed later in this report.

Chapter 2 – Avoiding the Crisis

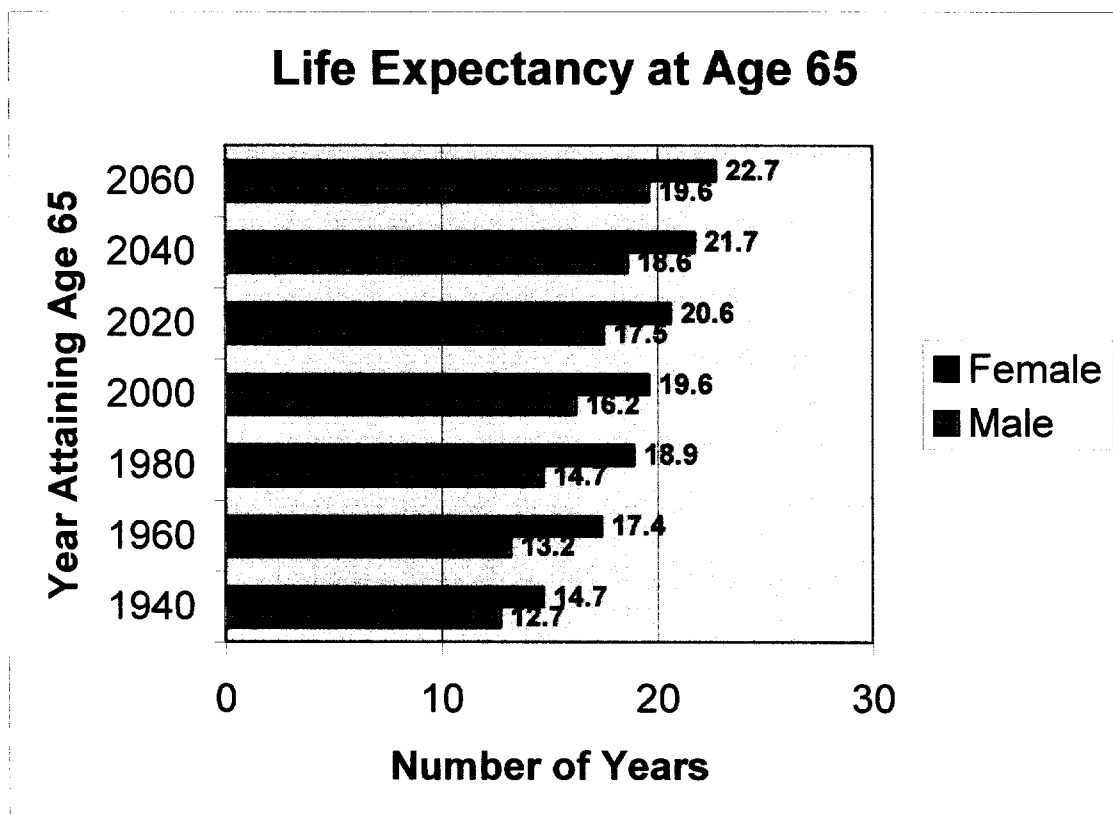
THE MAGIC NUMBER

Social Security's magic number is 2038. This means the funds will all be depleted by the year 2038. It is believed the funds will begin paying out more than it is taking in by the year 2016. Some people believe the only way to cure this problem is to increase taxes, reduce benefit payments, or increase governmental borrowing. As stated earlier, people do not "own" their own payments into Social Security. When they retire, current workers will pay for their Social Security benefits. The following graph shows the number of workers per retiree in the past, present, and future:

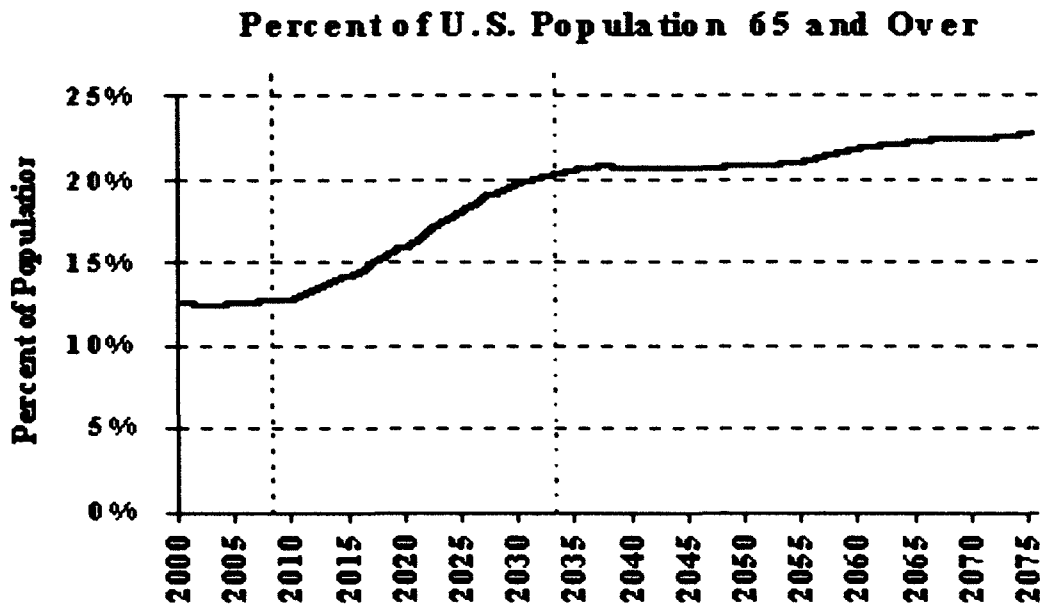


Source: Social Security Advisory Board, July 2001

In a released statement by the Social Security Advisory Board, President George W. Bush stated, "Social Security, itself, is becoming insecure." Some of the major issues include the fact that Social Security was founded in an era when people generally did not live past the age of 65 (Associated Press, July 20, 2001). Due to an increase in health care quality and ultimately the longevity of life, more and more benefits are being paid daily. As the graph above shows, fewer people are working to pay for current Social Security beneficiaries. This number will become even smaller when the Baby Boomer generation begins to retire. One of the offsets to this problem has been to increase the retirement age to 67. This seems to be a short-term solution rather than one that will save Social Security. The following graphs depict the life expectancy projections from 1940 to 2060 and the growing percentage of those who are and will be over 65 years of age:



Source: Social Security Advisory Board, July 2001



Source: Social Security Advisory Board, July 2001

Taking a few steps backwards, in January of 1981, a study was completed to see if an alternate plan could be created. This study was called the “Galveston Plan.” Under this plan, a model was created that proved to be the building blocks to a popular executive theory for Social Security reform: privatization. According to the Galveston Plan, it was concluded that there are more payout options under this plan, and, in general, pays more than Social Security (Wilson 3). This includes the categories of Social Security benefits, including initial retirement benefits, initial disability benefits, and survivor benefits. This was the beginning for an idea that is still around today, and it becomes a stronger belief structure for the future of Social Security.

PRIVATIZATION

The first thing that needs to be discussed is a definition of privatization. There is a lot of confusion as to what this actually means. According to the Cato Institute, which publicly supports privatization, Social Security privatization is a type of reform that will allow workers to deposit their taxes into accounts such as 401(k) plans or individual retirement accounts (IRAs). This selection would be purely at the discretion of that taxpayer. Workers would then select an appropriate company to manage and invest their money. Eventually, the money would grow and provide a substantial amount of money for use when retiring. An option that seems appealing to this type of reform is that a lifetime annuity could be purchased, which would pay a monthly retirement check. In all, Social Security, as it is known, would no longer be a public plan.

There appear to be many benefits to privatization. There would be higher returns and greater benefits. This is accomplished through the gain of assets during a lifetime. Also, people could own their own personal retirement accounts, which may be passed down to family members. Another benefit is a creation of wealth. Everyone will have the opportunity to invest in the United States economy, stimulating its growth as well as the overall wealth of the investor. There would also be a feeling of empowerment because workers would manage their own money and know exactly where it is going.

Proponents of a privatized plan argue that market investment, while it may fluctuate frequently, will rise over a long term. Since retirement for a worker is generally a long-term investment, making money through this plan is inevitable. Writers at the

CATO Institute generally agree the stock market is not as risky as people would assume. This appears to be a safe assumption because since the Great Depression, stock has always risen over a long-term timeframe.

This type of reform has recently become widely known and is slowly becoming the acceptable solution to all of Social Security's problems (Associated Press, August 9, 2001). According to a poll conducted by Newsweek on June 28, 1999, only 22 percent of those polled agreed Social Security should gradually raise the retirement age to 70. Over 50 percent agree that a privatized plan would be the best solution. Most of the people polled did not want to see taxes increase, even for employers. This is a good example of how appealing proponents of a privatized plan have made this idea appear. The positives and negatives of this plan have been debated continuously, and, later in this report, both viewpoints will be shown.

Many people are asking how close the government is to securing a privatized plan for Social Security. In May of 2001, President George W. Bush appointed a Social Security panel to review Social Security's status and promote the idea of a privatized plan. The 16-member panel was working to push privatization into a reality within two years. Based on their findings, the transition would be very complicated. They came up with three options for a privatization plan rather than just one. They conceded that such a transition would involve major cuts in Social Security's traditional benefits and large infusions of general revenue. They stated that no major change would be seen in Social Security until at least 2005. Still, there are people who are adamant about securing a privatized plan to avoid the eventual solvency of Social Security. Before showing both

sides of the issue further, it is necessary to evaluate the privatized system that exists in Latin America.

PRIVATIZATION IN LATIN AMERICA

Chile adopted a partially privatized social security system in 1981. Under their system, workers pay 10 percent of their earnings into an individual account run by a pension fund management company. When the worker retires, he or she has the option of an annuity, programmed withdrawals, or programmed withdrawals with a deferred annuity. The government plays a large role in this system, acting as a financial administrator in this system. One cost that they incur is their payment of the guaranteed minimum pension for all workers (Kritzer 2).

This system has seen its share of unresolved problems. The majority of the problems tend to be gender-based. With the current Social Security system in the United States, retirees of any gender can expect to receive the same amount of benefits. With the privatized system in Chile, women generally receive smaller pensions than men. The system provides no form of credit while a woman is in her child-rearing years. All the credits a woman would earn during that time are foregone. Also, women receive benefits based on their own earnings, which has been proven to be smaller than those of men.

Argentina is another country currently under a mixed social security system. Their surplus of funds ran out in the 1980s, causing a major crisis where the government had to make major changes in the system. Unlike in Chile, both workers and employers pay into the Argentine retirement system. Employees pay 11 percent to the social

security system. Of that, 3.42 percent is used for administrative fees, survivor insurance, and disability insurance. The rest is fed into the worker's individual account (Kritzer 8).

Like Chile, Argentina is seeing its share of unresolved issues. There are similar gender-based issues that have remained a problem. A major issue is the relatively low number of regular contributors to the system. About 50 percent of enrollees have been delinquent in making their contributions. In January of 2000, that figure rose to 54 percent. Another issue is the high administrative fees with this system. In February of 2000, the government agreed to lower the administrative fees up to 8 percent for those who currently contribute to the system (Kritzer 9-12).

Colombia faced a difficult situation in the early 1990s. Terrorism and violence were abundant, causing a substantial amount of turmoil for the government to handle. Opposing points of view caused the creation of a fully privatized social security program. Everyone except state-owned sectors went under this plan. This plan is much different from the other countries in that employees can choose between the public and private sections of the social security system, allowing a switch back and forth every three years if desired. Employees pay 3.375 percent regardless of their choice, and employers pay 10 percent of the payroll. There were problems that arose from this system.

The reform of 1993 did not solve one of the main problems it was designed to fix. The debt from the old system still stood, and, as yet, the country has not been able to resolve this debt. Another problem that surfaced was the issue of promotion. When the new system was designed and passed, little was done in terms of advertising the new system. In fact, they were reluctant to do this because of the debt from the old system. They wanted workers to remain with the old system to help resolve the debt. Another

problem is the high number of low-income affiliates. This creates a low level of contributions and a low level of earnings for the system (Kritzer 15-17).

Costa Rica adopted a system of voluntary individual accounts. Most of the programs offered from this government are similar to Social Security in the United States. Retirement benefits from the public sector are payable to men at age 62 and women at age 60 with at least 20 years of contributions. A disability pension is available for those who have lost two-thirds of their earning capacity. If a worker were eligible for a disability pension, that worker's family would receive survivor benefits should he or she pass away. As of 1999, there have been constant revisions to the system, and problems in the short-term and long-term have yet to be discovered (Kritzer 17-18).

Mexico had its problems with its old social security system for a number of reasons. Among them, reserves were not invested in a fund as strong as a United States trust fund. The rising cost of health care caused Mexico's system to fail. Benefits in this country were fairly generous compared to others, and contributions could not keep up with this. Only about 40 percent of the public paid into this system, causing coverage to be smaller than what it should have been. Individual accounts were made mandatory in 1997 that closely resembled the system in Chile.

One of the major problems in this new Mexican system is the amount of risk that a worker undertakes by investing in an individual account. This stems from the fact that low returns are shown when an individual handles his or her own account. A major holder in these accounts is a housing fund institute called INFONAVIT. This institute has constantly given low-interest loans for workers, which appeared to be an asset for a worker, but its financial troubles have shown the investment to be a poor one. In recent

years, returns have actually been negative, causing the Mexican government to consider a complete revamp of the current system (Kritzer 20-22).

In 1993, Peru introduced a system of private individual accounts as an alternative to its old public social security system. At first, the new system had higher contribution rates and a higher retirement age, making it less appealing than the old system. To offset this, the government required employers to pay a 13.5 percent increase on salaries if a worker chose the privatized program. Changes were finally made by 1998 to make both programs as equal as possible in terms of contribution rates and retirement age. It is still difficult to get workers to switch to the privatized system, which the government is pushing workers to do.

The number of contributors to the new privatized system is very small compared to those who are eligible for this system. Only 21 percent of the eligible population is involved in the privatized system. Now that employers are mandated to contribute to the privatized system, the transition is slow. Many unpaid contributions are surfacing, causing employers to receive fines and high interest rates on those unpaid contributions. In fact, the total of the fines and interest payable was nearly equal to the amount of assets under management (Kritzer 22-24).

All of the above countries have had to reform their social security programs because of certain crises. There is no easy way for any country to reform its social security program, and there are always going to be long and expensive transitions. These countries provide great and diverse examples of types of privatized structures. Looking at these privatized programs that the Latin American countries have adopted is essential in structuring a new system for any country.

Chapter 3 – The Views

TAKING SIDES – THOSE IN FAVOR

Being that privatization is such a complex issue, it is necessary to look at both sides of the picture. There are people who are strongly for this legislation, and there are people who are adamantly against the legislation. Proponents and opponents of such a system share much of the same information, but their future expectancies are quite different. In fact, those against privatization argue there is no crisis at all, that the whole issue was conjured by someone who was unhappy with the current system. Those for privatization hold that Social Security will be bankrupt sooner than we think (Diamond 21). The first side that will be discussed in this chapter is the pro-privatization viewpoint.

Karl Borden, a professor of financial economics at the University of Nebraska, says, “Social Security is an unfounded pay-as-you-go system, fundamentally flawed and analogous in design to illegal pyramid schemes.” Borden is among the many who truly believe Social Security will begin to see outlays exceed revenues around 2014. Short-term fixes in the system, like those seen every year, will not hold up according to proponents of a privatized system. They agree that the whole system should be derived from free markets and handed over to the private industry.

Earlier, the idea of the government acting as a fund manager was discussed. Those who believe Social Security should be privatized argue the government is a poor fund manager. Furthermore, they argue the government system does not actually accumulate trust funds at all. They say the budget system merely uses all current cash

receipts to meet current expenditures, and any excess goes toward a portion of the national deficit. They maintain that if the government should begin a trust fund now, its worth would be over \$12 trillion. This buildup, which would have to go into the private sector when the system is privatized, will represent a major ownership in the American stock market.

According to Karl Borden, those in favor of a privatized system believe the development of a privatized system should be based on five financial principles (7-8). The first principle is to build a reservoir of financial assets that represents claims against real assets used in the private sector to produce wealth. The second principle is that the system must tie individual account balances to retirement benefits so that each retiree's pension is financed by a store of wealth accumulated by that individual's contribution over his or her lifetime. The third principle is the new system must provide property rights to individuals that are given value by their own contributions. The fourth principle is to minimize restrictions on the individual's choice of where to invest their own wealth. The final principle for reform is to leave the decision about which financial securities to hold dispersed throughout the economic system. These principles are the basis for which many believe a privatized system would work. Tied into examples of what has happened throughout the world to date on privatized systems, their argument seems to be a well thought one.

In looking at the example Chile and other Latin American countries have given us, proponents of a privatized Social Security system are able to learn from mistakes that were made and provide us with a better solution (Borden 8-14). Their argument is that Chile is not under a true privatization plan. The government is responsible for the

provision of a minimum pension to all participants. Along with this, the government has the final say in where the money is allocated.

It is important to note at this time that there is no one definitive way to privatize Social Security. There have been many proposals for Social Security privatization in the past. One such proposal is called the Porter Plan. John Porter, a representative from Illinois, announced his plan in 1994. This plan was the first in a series of plans that would attempt to bring Social Security into a privatized system. Porter's plan consisted of many changes to the current Social Security system. One proposal was to cut Social Security payroll taxes by one percent for both the employee and employer. This tax cut would then be allocated to mandatory Individual Social Security Retirement Accounts, or ISSRAs. These accounts would be held in private-sector entities and would accrue tax-free interest for the working individual. In short, the system would not be fully privatized, but it would contain partial privatization.

The Kerrey-Danforth Plan is much broader in terms of approach than is the Porter Plan. The main suggestion with this plan involves the retirement age. The plan proposes that current retirement eligibility could still remain at 62, but full benefits would not be paid until the retiree is at least 67. Over the course of 30 years, the plan proposes an age increase for retirement to 70. Another change that would be made involves spousal benefits. This plan suggests the reduction of benefits from 50 percent to 33 percent of the primary recipient's benefit. Another major change would be investments in individual retirement accounts. The proposal was to make it mandatory for anyone under the age of 55 to contribute to an individual retirement account (Borden 16-18).

The Simpson-McMillan-Goss Plan is structurally similar to the Kerrey-Danforth Plan. There were some provisions that were made to make this a more appealing plan than the former. This plan proposed to eliminate the inclusion of state and local workers in Social Security, which the Kerrey-Danforth Plan overlooked. Another update that was made to that plan was to adjust the cost-of-living calculations. The rationale behind this was because the writers of the plan were convinced the cost-of-living adjustments, which compensate for inflation increases, were actually being too generous. They concluded that the rapid rise of benefits went beyond inflation. The last provision made was to allow workers to choose how much money was to be invested in their own individual retirement accounts (Borden 18-19).

The Kerrey-Simpson Legislation basically took what was already said in previous plans, cut some faulty portions out, and revise old data. The first change was a familiar one. By 2030, the retirement age would be increased to 70. Early retirement would increase from 62 to 65 in this time as well. It also stated to change the spousal benefits from 50 percent of the primary recipient's benefit to 33 percent, as was stated in the Kerrey-Danforth Plan. In addition, regarding individual retirement accounts, workers contribute two percent of their OASDI tax to those accounts. Along with this, employers will match the percentage (Borden 19-21).

All in all, the plan to privatize Social Security has been popular in recent years. There are many good points to privatizing Social Security, and many plans and legislations have been proposed to fix the inevitable problems plaguing Social Security. There are some people who believe privatizing Social Security would be the worst type of reform that could be done for Social Security. As with proponents of privatization,

those who are opposed make equally good points as to how we should fix Social Security.

TAKING SIDES – THOSE OPPOSED

Those against a privatized plan argue that privatization is too radical an idea for Social Security reform. At first glance, the idea of allowing workers to invest in the stock market with whole or part of their Social Security taxes would solve or alleviate some of the problems with Social Security. In essence, it looks great on paper and in theory, but it is one of the worst mistakes that can be done to solve Social Security. While it is true the stock market return is initially greater than Social Security, the main element missing in the theory is “security.”

Market investment cannot protect people against unforeseeable risks or problems. According to A.J. Cook, a writer for Scripps Howard News Service, the theory of investing in the stock market takes the assumptions that people won’t retire during a recession, they won’t become disabled before retirement, they won’t die prematurely and leave dependents behind, and major investment mistakes won’t be made. This appears to be too high a price to pay for a slightly higher return on market investments.

The American Federation of Government Employees conducted an extensive study into the problems Social Security is currently facing and may face in the future. They set out to debunk myths about the state of Social Security. They maintain Social Security is in great financial position. Even if there were no changes made to the program, it will still be able to pay benefits through the year 2032 (Duka, February 2002).

Keeping in mind that this myth is thrown out, it is a good indicator that Social Security is in good shape and will not need any reforms to keep it going for the next 30 years. Obviously, reforms and amendments will be made to prolong the unlikely event of solvency.

Another myth is that Social Security is a remnant of the past, and we don't really need it anymore. The American Federation of Government Employees maintains that 56 percent of the elderly would be living in poverty without Social Security. Two out of three elderly Americans rely on Social Security as more than half of their incomes. Thirteen million people depend on disability and survivor's benefits. The fact that Social Security is a guaranteed system and one that changes even with inflation increases, it is ridiculous to think Social Security is something we can all live without (Burtless 3).

Some proponents of a privatized system think there is no money in the Social Security Trust Fund. However, even during the Great Depression, government bonds have never defaulted on debt. In fact, opponents of a privatized system argue that investments in government bonds are safer than money in the bank because they never devalue and never go "out of business" (Cadette 12). In essence, those who think that the only thing in the trust fund is a pile of IOUs are mistaken.

There are also many other reasons to protect Social Security from privatization. Opponents argue privatization would require major cuts in benefits. If the government diverts two percent from Social Security taxes into private investment accounts, the initial cost would be \$900 billion, as stated by the Center for Budget and Policy Priorities. Current retirees would not have their benefits cut or even raised under the privatization plan (Hoffman, November 1997). However, most proponents of the

privatized system will use any kind of budget surplus for tax cuts for the wealthy. This idea does not protect current retirees in any way due to that initial cost plus tax breaks for the wealthy. Thus, a benefit reduction would be necessary for that plan to even survive.

One of Social Security's main points is providing lifelong retirement income. If people who invest in personal accounts outlive those investments, it will create a huge problem for retirees. Outliving an investment means that these elderly Americans may have to live with their children or rely on other means of obtaining an income (Lewis, November 1996). Also, a privatized plan would greatly reduce the worth of any kind of social insurance. There would be no disability insurance and no survivor's benefits. This would be a huge step backward for any social insurance program. The fact that Social Security is such a guarantee and that it even adjusts itself for inflation is reason enough to make amendments to it rather than flip the program on its head (Baker 46).

Basically, opponents of a privatized system are able to look at every facet of privatization and quickly return with a valid argument against actually privatizing Social Security. The arguments made are short, but they are genuinely effective. This debate has been going on for years, and this debate will continue as long as some people are in favor of a privatized system. Without such things as guaranteed payments, cost-of-living raises, independence after retiring, and a reasonable retirement age, a privatized plan will never be able to match what we have in America today. Appendix B discusses certain viewpoints of organizations that met at the White House in December of 1998 to discuss Social Security reform.

Chapter 4 – Conclusion and Recommendation

CONCLUSION

There is no denying the fact that the American population will inevitably have to rely on Social Security in the future more than it has in the past. Younger workers will have to work harder and longer in order to assure current and future retirees an insurance policy that is guaranteed. This program is the best we will ever have, and we need to protect this at all costs. There are many changes that need to be made and many things to review when looking at Social Security. Privatization, however, is not one of them.

When looking at some of the examples given before about privatization of a social insurance program, it is obvious the repercussions that can take place. Countries in Latin America are seeing some major problems with their privatized systems. We need to look at these problems and learn from them. Privatization is not the answer. We can take what has already been approved in other countries and adapt our system to what we see will fit our society. Everyone needs to look at their own future and ask him or herself if a privatized system is really in the best interest of our future as Americans. As stated on February 9, 1998, President Bill Clinton said, “Social Security reflects some of our deepest values – the duties we owe to our parents, each other, and our children and grandchildren” (Social Security Administration, Brief History 10). This comment alone stresses the idea to move forward as Americans and realize that even though changes have to be made, our Social Security system is the best form of social insurance we could possibly want.

RECOMMENDATION

Privatization can never work in the United States. It looks great on paper, and the right advocate can turn a skeptic into a believer. There are too many gray areas with privatization to allow it to work in America, including those mentioned in the last chapter dealing with cost-of-living adjustments, disability benefits, retirement benefits, and survivor's benefits. To change to this plan would undo any kind of social protection our government has been able to and always will be able to provide.

Reforms are needed if we are to keep Social Security afloat. There also needs to be a few policy changes in how the government handles the trust fund and surplus. What reforms are made are the result of what political party holds the most power in the United States government. Democrats favor the protection of Social Security. They see this as a necessary function of American society. Republicans view Social Security as a passing phase. The privatization of this program is strongly backed by Republicans and will continue to be this way for years to come. This issue has always been one of the key debates during elections because it is one of the most important ones that any politician can make. As Americans, we are forced to recognize Social Security as either a positive aspect or a negative bearer of our financial future. In essence, Social Security needs to remain what it is today and what it has always been in the past. Changes will always have to be made, as is the case with any major social insurance program.

My recommendations come from a substantial amount of research into the matter of privatization. Social Security taxes are paid at the same rate until the income of

\$72,600 for an individual. Small portions of Americans make more than this amount, but a recommendation of an equal tax withholdings needs to be assessed. This can help to build up a trust fund that will help alleviate the ideologies of skeptics for a positive future of Social Security. The positive impact of this taxation will be unlikely to be challenged since many believe it is only fair to tax equally. Proponents of a privatized system are believed to be designing a system that protects these individuals who earn more than this amount per year. This needs to be a fair system, as it has always been. Passing this idea will help balance out the rough areas in the program.

Another one of my recommendations is to either invest in a higher bond or to increase the interest rates of government bonds. Even the slightest percentage raise in these bonds can make a major impact on the Social Security reserve. This change has been a popular one over the years, and if it occurs again, the future solvency date of Social Security can be prolonged or even avoided completely. Building this surplus of benefits is crucial.

My third recommendation comes from funding of certain programs. Social Security, because of the immense surplus it already has, seems to be the first answer to financial woes for the government. "Borrowing" money from this program will not ease the problems it currently has and may have in the future. As it stands, the government needs to focus elsewhere on raising funds for certain programs, including military spending. When the surplus is used for other purposes, many other things are at stake, including a threat of not being able to pay future benefits as well as protecting the workers that help those in need of Social Security.

These are three simple recommendations that need to be considered. As of now, Social Security stands in decent financial shape. A few changes will always need to be made, and it is no argument that it will never be considered a “perfect” social insurance program. With reforms and logical changes, Social Security can remain a positive program for those who will likely need it in the future. We need to take a longer look at our future and realize Social Security will play a major role.

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Appendix A: Key Dates in the History of Social Security

The following important dates come from Social Security Administration's Brief History of Social Security Internet page.

06/8/34— Federal legislation to promote economic security was recommended in President Franklin D. Roosevelt's Message to Congress.

06/29/34— President Roosevelt created the Committee on economic Security to study the problems related to economic security and to make recommendations for a program of legislation.

01/17/35—The Committee on Economic Security's recommendations were introduced in the 74th Congress.

04/19/35—The Social Security Act was passed in the House of Representatives, 372 to 33.

06/19/35—The Social Security Act was passed in the Senate by a vote of 77 to 6.

08/14/35—The Social Security Act became law with President Roosevelt's signature.

08/23/35—The Senate confirmed the President's nomination of the original members of the Social Security Board, John G. Winant, Chairman; Arthur J. Altmeyer, and Vincent M. Miles.

10/14/36—The first Social Security field office was opened in Austin, Texas.

11/09/36—The Baltimore office for record-keeping operations opened in the Candler Building.

11/24/36—Applications for Social Security account numbers were distributed by the Post Office.

01/01/37—Workers began to acquire credits toward old-age insurance benefits.

01/37—First applications for benefits filed. Ernest Ackerman, a retired Cleveland motorman, was among the first to apply.

02/19/37—President Roosevelt accepted the resignation of John G. Winant from the Social Security Board and appointed Arthur J. Altmeyer as the new Chairman.

03/11/37—First Social Security benefits paid (one-time payment only).

07/01/39—Under the Federal Reorganization Act of 1939, the Social Security Board was made part of the newly established Federal Security Agency.

08/03/39—Arthur J. Altmeyer was reappointed to a 6-year term as the Chairman of the Social Security Board.

08/10/39—The Social Security Amendments of 1939 broadened the program to include dependents and survivors benefits.

01/31/40—Ida May Fuller became the first person to receive an old-age monthly benefit check.

11/19/45—In a special message to Congress, President Truman proposed a comprehensive, prepaid medical insurance plan for all people through the Social Security system.

07/16/46—Under the President's Reorganization Plan of 1946, the Social Security Board was abolished and the Social Security Administration was established. Arthur J. Altmeyer was appointed as the first Commissioner.

08/28/50—President Truman signed the 1950 Social Security Amendments.

09/01/54—Social Security Amendments established a disability "freeze" to help prevent the erosion of a disabled worker's benefits.

08/01/56—The Social Security Act was amended to provide monthly benefits to permanently and totally disabled workers aged 50-64 and for adult children of deceased or retired workers, if disabled before age 18.

06/30/61—The Social Security Amendments of 1961 were signed by President John Kennedy, permitting all workers to elect reduced retirement at age 62.

07/30/65—President Lyndon B. Johnson signed the Medicare Bill in the presence of former President Truman who proposed this legislation in his message to Congress in 1945.

10/12/66—President Johnson visited the SSA's headquarters to participate in the 15th Annual Honor Awards Ceremony -- the first visit by a President.

12/30/69—President Nixon signed the Federal Coal Mine Health and Safety Act. Monthly cash benefits were provided coal miners who became totally disabled because of Black Lung disease, and for their dependents and survivors.

07/01/72—President Nixon signed into law P.L. 92-336 which authorized a 20% cost-of-living adjustment (COLA), effective 9/92, and established the procedures for issuing automatic annual COLAs beginning in 1975.

10/30/72—Social Security Amendments of 1972 signed into law by President Nixon -- creating the Supplemental Security Income (SSI) program.

01/19/73—The Administration Building at SSA headquarters was renamed the Arthur J. Altmeyer Building, in memory of the late Commissioner.

01/01/74—SSI program went into operation as a result of the Social Security Amendments of 1972.

03/09/77—HEW reorganization plan published in Federal Register, creating the Health Care Financing Administration to manage the Medicare and Medicaid programs.

06/09/80—President Carter signed the Social Security Amendments of 1980. Major provisions involved greater work incentives for disabled Social Security and SSI beneficiaries.

08/13/81—The Omnibus Budget Reconciliation Act of 1981 made major changes in Social Security, SSI and AFDC. These included: a phasing out of student's benefits; stopping young parents benefits when a child reached 16; limiting the lump-sum death payment and changes in the minimum benefit.

01/20/83—The National Commission on Social Security Reform sent its recommendations for resolving the Social Security program's financial problems to the President and Congress.

04/20/83—President Reagan signed into law the Social Security Amendments of 1983.

10/09/84—Disability Benefits Reform Act of 1984 signed by President Reagan.

08/14/85—Social Security celebrates its 50th Anniversary.

06/06/86—President Reagan signed the Federal Employees' Retirement System (FERS) Act, which established Social Security coverage for federal employees hired after December 31, 1983.

10/01/88—Nationwide 800 number service implemented.

02/20/90—The Supreme Court held in Sullivan vs. Zebley that substantial parts of the SSI regulation on determining disability for children are inconsistent with the Social Security Act.

05/17/94—SSA's Internet site was launched on the World-Wide Web (SSA Online at <http://www.ssa.gov>).

03/31/95—SSA became an independent agency.

04/19/95—The Alfred P. Murrah Federal Building in Oklahoma City, Oklahoma, was bombed, killing 168 individuals, including 16 SSA employees.

08/22/96—President Clinton signs welfare reform bill.

09/28/97—Kenneth S. Apfel sworn-in as Commissioner of Social Security.

01/27/98—In his State of the Union address, President Clinton states, "Save Social Security First."

12/08-09/98—The first-ever White House Conference on Social Security was held in Washington, D.C.

10/01/99—SSA begins annual mailing of Social Security Statement to all workers age 25 and over.

11/22/99—William A. Halter was formally sworn-in as Deputy Commissioner of Social Security, and James G. Huse, Jr. was sworn-in as Inspector General of Social Security.

12/17/99—President Clinton signed the "Ticket to Work and Work Incentives Improvement Act of 1999."

04/07/00—President Clinton signed into law a bill eliminating the Retirement Earnings Test (RET) for those beneficiaries at or above Normal Retirement Age.

Appendix B: The White House Conference on Social Security

On December 8-9, 1998, various individuals, companies, and organizations came together at the White House to give their input on Social Security reform. Responses and recommendations varied greatly, and it proved to be a big step toward a national understanding of the condition of Social Security now and in the future. The following pages are excerpts from that report.



STEPHEN MOORE
Director of Fiscal Policy Studies

SAVING SOCIAL SECURITY FIRST:
THE PERSONAL SECURITY ACCOUNT OPTION

Stephen Moore

President Clinton is to be commended for convening the bipartisan summit on saving Social Security. One issue that all sides should be able to agree is that we have to act now to solve the \$5 to \$10 trillion funding shortfall in the Social Security system. If we wait 5 or 10 years the financing crisis will be right upon us, and our range of options to save the system will be far more limited. We can see the Titanic headed for the iceberg, we need to start turning the ship around immediately.

In April of 1998 during the first town hall meeting on Social Security convened by the White House, President Clinton declared:

The Social Security system must remain universal, fair, and must deal with the problems of the disabled and the poor. If you do all that, could you construct some system which also made allowance for private accounts? I think you could, yes.

I think he is right. For the past 20 years the Cato Institute has endorsed transforming Social Security from a pay-as-you-go system, to a fully financed, individually invested program. In other words, American workers should be permitted to fully and immediately invest their Social Security payroll taxes (12 percent of their paycheck) into Personal Security Accounts (PSAs). There are 3 critical safety features to the PSA plan that I believe would satisfy the President's concerns:

- 1) Every American currently receiving (or about to receive) Social Security benefits will be guaranteed that his or her payments will not be cut. Seniors should be held harmless to the change.
- 2) All American workers will be given the option of staying in the traditional Social Security system or investing their money in a PSA that is controlled and owned by the individual worker.
- 3) Every worker, whether they stay in Social Security or choose a PSA, will be guaranteed a minimum retirement benefit when they retire. In other words, there will be a safety net feature to the program.

Why should American workers and politicians favor converting Social Security to a system of PSAs? Because it offers workers a better deal. Even if workers were required to invest in non-risky investments, the rate of return on their money and their subsequent retirement income would be substantially higher than if it remained in the Social Security system. This statement is true whether the worker is black or white, man or woman, rich or poor, married or single. A median income worker born in 1970 will receive a Social Security benefit of \$1,429 (assuming benefits are not cut), but with a 10 percent PSA invested in 40% bonds and 60% stocks the worker would receive a monthly benefit of \$2,654. If the entire 12 percent payroll tax were put in a PSA the benefit would exceed \$3,000 per month.

The general rule of thumb is that a typical worker would have a benefit twice as high under PSAs than Social Security. This analysis reasonably assumes that over the next forty years the return in financial markets will be comparable to the average rate of return from 1926-96. Americans who wish to assess how they personally would fare under a PSA system should try the Cato Institute's Social Security calculator on our web page: www.socialsecurity.org.

It is important to emphasize that virtually all of the Social Security "reforms" proposed by opponents of PSAs would simply lower the already poor rate of return for young Americans. In other words, any "reform" option that raises the payroll tax rate or the payroll tax income threshold, that lowers future benefits, or that raises the retirement age, only worsens the rate of return for today's worker and future generations. These options should therefore be rejected. We talk a lot about "fairness" in Washington. If fairness is to be one of our guiding principles in the search for a Social Security solution, we should not force our children to pay more in or get less out of a system that is already severely inequitable to them.

How can we finance the transition from pay-as-you-go financing to a fully funded PSA system? First, we should dedicate every penny of the current Social Security surplus to helping finance PSA's while still paying benefits to seniors. Over the next 10 years this surplus will amount to nearly \$1 trillion. Second, we should examine other areas of the federal budget that could be reduced and dedicate the savings to helping finance PSAs. We at Cato have identified almost \$100 billion a year in corporate welfare. Cut these Fortune 500 subsidies and use the savings to finance PSAs. Finally, the federal government should issue 50 year liberty bonds--taking advantage of the current low long term interest rates--to fund the remaining transition to PSAs. This reasonably spreads the cost of the transition to a new Social Security retirement system across future generations. This seems to be an equitable solution, since future generations will be the primary beneficiaries of a fully funded, high rate of return, PSA system.

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BOSTON COLLEGE

THE PETER F. DRUCKER CHAIR IN MANAGEMENT SCIENCES
THE WALLACE E. CARROLL
SCHOOL OF MANAGEMENT

STATEMENT OF ALICIA H. MUNNELL*

The best way to assure all Americans an adequate basic retirement income is to maintain the current defined benefit structure and not to move toward a system of defined contribution accounts. Let me briefly summarize the reasoning behind that conclusion.

I. Social Security is not facing a crisis. The projected increase in Social Security spending due to the aging of the population is neither enormous nor unprecedented. The cost of the program is projected to rise by 2 percent of GDP. Budget changes equal to 2 percent of GDP are not uncommon; defense spending increased by 5 percent of GDP at the start of the cold war and declined by 2 percent between 1991 and 1998. The financing situation does not require radical change.

II. The desire to increase national saving and broaden investment options for workers—changes that have been used to justify individual accounts—can be achieved more effectively within the structure of the current program.

- The federal government can accumulate reserves. The non-Social-Security portion of the budget is headed for balance in 2002. We can keep it there and build up reserves in the Social Security trust funds. The states do it for their pension funds; the federal government should be able to do it for its major retirement system.
- Broadening Social Security's investment options to include stocks is feasible. We know how to prevent interference in private sector activity: set up an independent investment board, invest in a broad index, and delegate voting rights to fund managers.

III. The economics are clear: Social Security's defined benefit plan is better than individual accounts for providing Americans with their basic retirement pension.

- Because Social Security is a defined benefit plan, it can spread risks across the population and over generations. This means that individual retirees would not risk large losses in the stock market just as they approach retirement. The risks would not disappear, but gains and losses could be averaged over time and among the entire population.

* The author served as a Member of President Clinton's Council of Economic Advisers and Assistant Secretary of the Treasury for Economic Policy.

- Pooling investments in the Social Security trust funds also keeps transaction costs low, ensuring higher net returns than individual accounts. Administrative costs for individual accounts are likely to amount to a 20-percent cut in benefits. Data from the U.K. and Chile, countries that have adopted individual accounts, suggest that the costs could be even higher. Annuitizing individual accumulations reduces benefits by another 10 percent.
- Social Security also avoids the pressure for individuals to gain early access to their accounts, leaving retirees with inadequate retirement income. This risk is very real; individuals already have access to funds in IRAs and 401(k) plans.
- Social Security assures that accumulated funds are transformed into inflation-indexed annuities so that retirees do not outlive their retirement resources. Private annuities are over-priced for the average person, and Inflation-adjusted annuities are not available in the private sector.
- Social Security provides full benefits for disabled workers who would not have time to build up adequate reserves under a system of individual accounts. Disability benefits would be cut under all existing plans for individual accounts.
- Social Security protects women. It provides spouse's and widow's benefits; it automatically provides inflation-adjusted annuities (women live longer than men), and it protects divorcees (after ten years of marriage). Private accounts contain none of these protections.
- Finally, Social Security protects those with a lifetime of low earnings by replacing a greater percentage of earnings for low earners than for high earners. This redistributive component would be lost to the extent that payroll taxes were diverted toward individual accounts.

IV. There is no reason to move towards a defined contribution system; much of the projected shortfall can be eliminated with good policy changes.

- For example, extending coverage to new state and local workers, slightly increasing the maximum taxable earnings base, and reflecting BLS corrections to the CPI in the COLA are all consistent with the goals of the program.
- Broadening the investment options for the trust funds to include stocks will increase the return on fund reserves and close the remaining financing gap.

V. The argument against individual accounts applies only to the basic retirement income. On top of a fully financed Social Security system that preserves today's promises, voluntary supplemental individual accounts administered by Social Security are a good idea. They would encourage additional saving and keep administrative costs to a minimum.



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**American Federation of Teachers
Statement
on
Social Security Reform**

Below are the principles adopted by the American Federation of Teachers which will guide our union in working to develop a program to assure the financial stability of the Social Security system for the next 75 years.

It is our strongly held belief that the maintenance of the Social Security benefit is essential to protect future beneficiaries as well as assuring future workers that reasonable benefits will be there for them when they retire.

For more than 60 years, Social Security has been the most successful and broadly supported federal government program providing basic living standards to thousands of our parents and grandparents, and raising many retiree households out of poverty.

Further, Social Security is one of the pillars of retirement income for American workers and provides guaranteed retirement, survivorship and disability protection to more than 44 million Americans at all stages of life.

Finally, the Board of Trustees of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund estimates that the Trust Funds will be solvent for the next 30 years, providing time to discuss and examine alternative solutions with deliberation and care.

The American Federation of Teachers believes that any proposed remedies should meet the following principles:

- Consider solutions within the existing Social Security structure that maintain economic security for current and future generations by guaranteeing an inflation-adjusted retirement income that permits older family members to live in dignity and reduces the economic burden on younger family members of caring for their parents, grandparents, aunts, uncles, brothers and sisters.
- Provide universal insurance protections for dependent and surviving children and spouses of a deceased family wage earner as well as disabled and retired workers.

- **Reject radical solutions, like using Social Security resources to finance private accounts that require significant reductions in guaranteed benefits or increases the retirement age.**
- **Maintain a larger share of past earnings for low-income workers, as in the present system, and continue to provide larger benefits to workers who earn higher wages during their careers.**
- **Support covered workers who expect to receive Social Security benefits after a career of work and non-covered workers by maintaining their anticipated non-Social Security benefits on which they base their employment decisions.**
- **Support President Clinton's proposal to use the federal budget surplus to strengthen the current Social Security system.**
- **Support pension coverage for all workers who do not have a pension and provide for adequate benefits and funding for workers with pension coverage**

Finally, there is a proposal that is of special concern to our union. That proposal is to mandate Social Security coverage for presently uncovered state and local employees. While this proposal sounds reasonable, it ignores the fact that on average both local governments and workers each contribute 8 percent of their wages to finance local retirement systems. Forcing each to pay an additional 6.2 percent for Social Security could lead to the dismantling of state retirement systems, placing in jeopardy the benefits of current state and local retirees as well as those of future state and local retirees. This proposal should not be considered.

AFT looks forward to working on a equitable Social Security reform package. Social Security is one of our greatest achievements as a nation, and it must be preserved.

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opeiu#2afl-cio

AFGE OPPOSES ALL FORMS OF SOCIAL SECURITY PRIVATIZATION

The American Federation of Government Employees, AFL-CIO (AFGE) is equally opposed to privatizing Social Security into a system of individual accounts or privatizing the investment of the OASDI Trust Fund.

The arguments against individual accounts are well known: They undermine the progressive character of the program, they put too much risk on individuals, they are inefficient (costing hundreds of millions in unnecessary fees and profits to Wall Street firms), and the transition is costly, requiring tax increases, benefit cuts, and/or retirement age increases.

AFGE's opposition to "collective" or "direct government" stock market investment have to do with: (a) the impact on the federal budget, (b) the loss of democratic/popular control over the investment of the Trust Fund, (c) the inherent risks to benefits, and (d) the fact that the "rate of return" arguments which favor privatization cannot be reconciled with the Social Security Trustees' projections of a Social Security solvency problem.

. *Collective private investment would have an enormous and harmful impact on the federal budget.* Investing even as little as 40 to 50 percent of the Trust Fund in private equities would require initial federal outlays of between \$60 and \$80 billion. In the context of balanced budget politics, this money would have to come either from spending or new taxes. We predict massive spending cuts, affecting federal jobs and benefits, as well as further general budget pressure on the programs and agencies all Americans depend on. Indeed, some backers of this proposal consider the attendant reduction in government spending its highest virtue.

. *The issue of democratic control, reflected in the debate over the benefits of private vs. public investment, is an important one for working families.* Those Republicans that favor individual accounts said it would give Americans *more control* over the way their Social Security taxes were invested and that Democrats didn't trust people to have that control. The strength of this populist rhetoric is lost on advocates of collective private investment. While individual accounts give the illusion of control, the collective privatization plans explicitly prohibit any democratic control. Meanwhile the *status quo*, which provides the only real democratic control, is unappreciated for what it is.

Treasury bonds, unlike corporate bonds, are invested for the public good by those who are democratically elected to represent the public. In contrast, all plans for "collective" private investment so far have insisted upon strict rules prohibiting government "interference" in corporate governance. Trustees of a privatized financing system for Social Security would have a fiduciary responsibility to support corporate plans to maximize profits. Unfortunately, maximizing profits has increasingly come to mean shipping American jobs overseas, compromising the environment, and violating the rights of workers both in the U.S. and abroad.

- *Privatizers may hope for the best, but the majority of Americans who depend on Social Security must prepare for the worst.* There have been several sustained downturns in the private equity markets since the establishment of Social Security, some of a magnitude which would have threatened the ability of a privatized Social Security Trust Fund to pay full benefits. Yet Social Security, entirely insulated from fluctuations in the private equity markets, has never missed a payment in 60 years.

There is no way that advocates of collective private investment can guarantee that if the stock market investments do not perform as promised, benefits will not be cut. On the contrary, there is every reason to believe that Americans will be told that they collectively accepted the risks of the stock market when they "agreed" to private investment and must swallow benefit cuts or tax increases to keep the system "in balance." The "political risk" from privatization easily equals the "market risk" with respect to benefit guarantees.

- *It is important to remember that the proverbial "pot of gold" may not be waiting at the end of the rainbow.* Advocates of privatization --either collective or individualized -- claim that stock market investment can "solve" Social Security's funding problems over the next 75 years by yielding a higher rate of return than the current financing system. They base this argument on models that assume economic growth in the future similar to that of the past. That assumption is inconsistent with the Social Security Trustees' projections that U.S. economic growth rate will decline from an average of roughly 3.5% over the past 75 years to 1.5% over the next 75 years. It is this questionable forecast that is used to suggest Social Security faces a funding problem beginning around 2032.

Privatization advocates cannot have their cake and eat it too. We cannot have both fast and slow economic growth in the same years. One set of projections must be wrong: Either there is no looming Social Security financing problem, or stock investments would exacerbate the problems, rather than be part of the solution.

- *The "rate of return" arguments advanced by privatization advocates are a red herring.* The issue goes deeper than whether Mutual Fund appreciation is higher than a Treasury bond yield. Rate of return in the context of a social insurance program like Social Security is more profoundly about our government's role in income redistribution, and whether Social Security benefits should replace a higher portion of the pre-retirement income of low and middle-wage earners than it does for high income earners.

Social Security's progressive benefit structure gives a superior "rate of return" to those in the bottom half of the income distribution, the same Americans who are likely to rely upon Social Security for almost all of their retirement income. This group would have nothing to gain in terms of "rate of return" from any version of Social Security privatization.

- *The 50,000 workers at the Social Security Administration, represented by AFGE, are the best in the business.* Private sector insurance companies and pension investment firms have administrative overhead averaging 40% ,while SSA's overhead costs are just under 1% of benefits.



STRENGTHENING SOCIAL SECURITY FOR YOUNG WORKERS

FOR MANY YOUNG ADULTS, economic prospects have deteriorated sharply in recent years. According to the U.S. Department of Education, from 1972- 1995, annual incomes for young adults age 25-34 plunged twenty-one percent for college graduates and thirty-five percent for high school graduates. The Clinton economic expansion is helping, but it cannot continue forever. A long-term commitment to full employment at living wages is still needed.

The problem results from poor standards in many of the new jobs created in our economy: part time, small business, service sector and temporary jobs. These are the jobs of the future.

As the Social Security debate moves forward, policymakers should recognize the broader economic context of America's new workplace and seek solutions that will leave younger generations with a solid safeguard for an uncertain future.

SOCIAL SECURITY MATTERS to young adults for many reasons. While annual incomes for young adults have plummeted since 1972, pension coverage for workers age 25 or less dropped one-third; for workers age 25-29, coverage dropped fifteen percent, according to the Department of Labor. The jobs of the future hold little promise of improvement.

Only 3.1 percent of temporary employees — half of whom are age 20 - 34 -- have a 401(k), and not one has a pension, through their employment. Similarly, only eighteen percent of workers in small businesses (fewer than twenty-five employees) have any retirement plan. According to the Department of Labor, small businesses created seventy-five percent of all new jobs in 1995.

As Commissioner Kenneth Apfel has remarked, one-third of all Social Security beneficiaries are not retired. They are survivors, disabled workers, and their families. Many of these young families depend upon Social Security to pay rent and medical bills or finance an education.

Far from being millionaire internet entrepreneurs, most young adults will be working in service sector jobs of short duration, with few of the safeguards that once existed for workers in the manufacturing economy. These young workers need Social Security to be there for them, and they need Social Security's future resolved in a manner that strengthens the basic survivors, disability, and retirement guarantees.

PRIVATIZING SOCIAL SECURITY IS WORSE for Generation X workers than any other age group. Privatization is touted as a remedy for illnesses said to afflict younger generations — the so-called ravage of overly abundant grandparents, a government that cannot be trusted to keep its promises, or a 21st Century American economic Ice Age. Privatizing Social Security will solve none of these problems.

Unfortunately, many young people have come to believe that Social Security will not be there for

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them (the depth of this belief, however, is not clear; it may be quite shallow). While privatization advocates claim that an individual account will restore some of their faith in Government, this claim is false both in fact and motivation. More likely, it will foster an attitude that our interests are best served by abandoning collective commitment.

More importantly, young people have never been told what privatization would do to the Social Security Trust Fund. Most young people do not want an "alternative" to Social Security; they just want Social Security to be there for them. If a privatized account will accomplish that goal, they might favor the proposal. If a privatized account threatens Social Security, they will oppose the proposal. Non-biased opinion research reaches this conclusion.

In order to divert a portion of payroll taxes into privatized accounts, privatizers must reduce Social Security guaranteed benefits for future generations by 20 - 40 percent and increase the retirement age. Worse, the benefit cuts seriously jeopardize millions of survivors and people with disabilities. Every privatization proposal either cuts survivors and disability benefits dramatically (15-30 percent) or has no plan at all for raising the large amounts of revenue needed to keep benefits intact. These young adults' benefits will go first to the chopping block.

STRENGTHENING, NOT UNDERMINING Social Security is the best course. Taking Social Security off budget, investing the surplus like a pension, applying FICA more fairly to wealthier workers, using general revenues, and indexing FICA to increases in life expectancy (\$2 annually) are all good options. The distinction between a good proposal and a bad proposal is the degree to which it will assure the safeguard of Social Security's guaranteed benefits.

There is agreement that the Federal budget surplus can be used to strengthen Social Security, and that significant benefit cuts or tax increases should be off the table. Individual accounts are a viable option, if they are a voluntary supplement requiring no cuts in Social Security benefits.

Common ground can exist if policymakers heed public opinion. In polls by Americans Discuss Social Security, the public, when presented with the trade-offs involved with various options (such as private accounts), choose *security* over risk every time, even if it means higher FICA contributions. In the 2030 Center poll, 86 percent of all Americans say that "Congress should not reduce benefits or raise the retirement age in order to fund individual accounts."

THE 2030 CENTER is a public policy organization for young adults, founded in 1997 to provide a voice for young people's economic concerns in order to reverse the deterioration of their economic circumstances.

The 2030 Center is at the forefront of developing progressive strategies to strengthen Social Security. We speak to audiences of all ages, write articles and op-eds, advise Congressional staff, conduct survey research and policy development, train young leaders, and provide a younger generations' perspective for major events and the media.

In the summer of 1998 we released a national poll on Social Security reform, conducted by Peter Hart Research, which found deep support among young adults for Social Security. This month, we released our policy manual, *Strengthening Social Security for Young Workers*.